FILED
DEC 6 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-630

NORTEK, INC.,
Petitioner,

v.

ALEXANDER GRANT & COMPANY, et al.,
Respondent,

v.

SANI DISTRIBUTORS, INC., et al.

BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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STATEMENT OF THE CASE

This case arises out of the purchase by petitioner for 22 million dollars of a number of related corporations known as the "Webb Group". For tax purposes, separate contracts were simultaneously executed for the purchase of each of the companies in the Group. Prior to the execution of these contracts, the selling corporations had retained Alexander Grant & Company (Grant) to audit and certify their financial statements. At the time the purchase contracts were executed, Grant had not completed its audit, and the purchase terms were fixed on the basis of unaudited statements previously prepared by another accounting firm.

Petitioner's President testified at his deposition that the purpose of the Grant audit was solely to confirm the unaudited figures used in fixing the contract terms, and that petitioner was bound to consummate the purchase if the unaudited figures were, in fact, confirmed (Ralph Papitto Dep., p. 21). The figures certified by Grant did confirm the unaudited financials and the purchase was consummated in accordance with the previously executed contracts.

Subsequent to consummation of the purchase and a later sale of the Webb Group by it, petitioner took the position that the audited financial statement of one of the Webb companies overstated retained earnings by $643,000. The figure for retained earnings shown on the audited statement was, however, more than $643,000 in excess of the figure shown for retained earnings on the unaudited financials used in negotiating the terms of the purchase contract. Accordingly, even if the certified figure for retained earnings had been prepared in accordance with petitioner's theory of proper accounting, petitioner would have been bound to proceed with the purchase pursuant to the already executed contracts.

Petitioner filed identical actions in Rhode Island and Florida seeking damages in the amount of one million dollars from Grant pursuant to Section 10b of the Securities Exchange Act of 1934 and various state law theories. The Court in Rhode Island found that all the significant events in the case had taken place in Florida, and transferred the Rhode Island Complaint to the District Court for the Southern District of Florida.* The Florida Court dismissed

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* The contacts with Florida include the following: (1) Grant was retained in Florida; (2) Webb was a Florida Corporation with its principal place of business in Florida; (3) Grant performed its audit work in Florida; (4) Petitioner's contract to purchase Webb was executed in Florida; (5) Grant's certification was delivered to Webb in Florida; and (6) the purchase was consummated in Florida.

the Rhode Island Complaint without prejudice, and the parties proceeded to litigate the Complaint originally filed in Florida to judgment. Petitioner did not object to the dismissal of the Rhode Island Complaint or make any effort to reinstate it prior to the entry of the summary judgment against it on the Florida Complaint.

The District Court's entry of summary judgment in favor of Grant was based on several grounds. With respect to the federal securities law count, the Court found both that it was barred by the applicable statute of limitations and that the uncontested facts established as a matter of law that the alleged error was neither material nor relied upon.

ARGUMENT

I. THE QUESTION OF WHICH OF THE FORUM STATE'S STATUTES OF LIMITATION SHOULD BE APPLIED TO AN ACTION BROUGHT UNDER SECTION 10b OF THE SECURITIES AND EXCHANGE ACT IS NOT APPROPRIATE FOR CONSIDERATION BY THIS COURT.

The Securities Act of 1934 provides no statutory limitations periods for actions brought under Section 10b since the Act does not itself create a civil action for violation of that Section. In applying the Act, the Courts have, accordingly, applied the traditional federal rule that, where a federal statute prescribes no limitation period, the Court will adopt the most appropriate period prescribed by the law of the forum state (*International Union* v. *Hoosier Cardinal Corp.*, 383 U.S. 696 (1966)).

Petitioner contends that this Court should require that in every state the limitation period applicable to common law fraud be applied to federal claims based on Section 10b. Petitioner asserts that such a holding would eliminate a conflict within the Circuits, would create uniformity, would be consistent with the scienter requirement in a Section 10b action, and would further the policy of the federal securities laws. In fact, there is no conflict among the Circuits,

and adoption of petitioner's argument would not create uniformity, would not result in the application of the most appropriate available limitation period, and would create substantial injustice with respect to those who have relied upon prior decisions.

In the context of a doctrine requiring reference to the law of 50 potential forum states, it is obviously meaningless to discuss a need for uniformity or a conflict among the Circuits. The Courts, in order to select the proper limitation period, are required to, and in fact have, analyzed the law of the particular forum state involved to select the limitation period applicable to the state cause of action which bears the closest substantive resemblance to a Section 10b action. This analysis has inevitably resulted in the adoption of different types of limitation periods within different forum states. In each case, however, the selection has resulted from an analysis of many variances in the provisions of the forum state's laws rather than from any conflict among the Circuits.

The instances in which decisions within a single Circuit apply different types of limitation periods in different states establish that such variations do not arise from substantive differences with respect to the requirements of federal law. In the Sixth Circuit, for example, the Court of Appeals applied the Michigan fraud limitations period to a Section 10b action in *Charney* v. *Thomas*, 372 F.2d 97 (6th Cir. 1967), basing its choice on the absence of a provision analogous to Section 10b in the securities laws of Michigan and on the fact that no prior decision had applied a state securities limitation period to such an action. Subsequent to *Charney*, however, in *Nickels* v. *Koehler Management Corporation*, 392 F.Supp. 804 (N.D. Ohio 1975), a District Court within the Sixth Circuit chose to apply Ohio's securities law limitation period rather than its fraud limitation period. In doing so, the Court distinguished *Charney* on the basis of several differences in the Michigan and Ohio securities and fraud laws.

Similarly, there have been varying results in different forum states within the Eighth Circuit. In *Vanderboom* v. *Sexton*, 422 F.2d 1233 (8th Cir. 1970), the Court of Appeals applied the Arkansas securities limitations period, rather than its fraud period, to a Section 10 action. Subsequently, however, two District Courts within the Eighth Circuit, citing and relying upon the type of analysis made by the Court in *Vanderboom*, chose, on the basis of differences in the relevant state laws, to apply fraud, and not securities, limitation periods to actions brought in Minnesota and South Dakota. *Klapmeier* v. *Peat, Marwick, Mitchell & Co.*, 363 F.Supp. 1212 (D. Minn. 1973); and *Rude* v. *Campbell Square Inc.*, 411 F. Supp. 1040 (D. S. Dak. 1976).

Petitioner's contention that a requirement that the forum state's fraud limitation period be applied in every case would establish uniformity entirely ignores reality. The differences in the limitations periods for fraud in the 50 states are so great that their consistent application might increase, rather than decrease, the variances in the limitation periods applicable to Section 10b actions. In Section 10b cases which have actually adopted the forum state's fraud limitation period, for example, the applicable time period has ranged from 10 years in *Denny* v. *Performance Systems, Inc.*, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rptr. Para. 93, 387 (M.D. Tenn. 1971) to one year in *Weiser* v. *Schwartz*, 286 F.Supp. 389 (E.D. La. 1968), and *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960). As Professor Loss observed with respect to whether the categorization of the federal action among the several state statutes of limitations should be a matter of federal or state law (Loss, Securities Regulation, Vol. III, p. 1774 (1961 Ed.):

> "The . . . question is of little practical significance. Since national uniformity in classification is precluded by the diversification in state limitation categories, submission of the choice of limitations to state law would add little to the variation caused by differing time periods."

Petitioner's claim that the fraud limitation period should be universally adopted because a longer period is more consistent with the policy of the Securities laws is incorrect in two respects. Given the fact that, regardless of what state limitation period is chosen, that period will not, as a matter of federal law, begin to run until discovery of the fraud*, a shorter limitation period appears to be justified. In connection with the 1934 amendments to the securities laws, Congress reduced the limitation periods applicable to sections of the Securities laws for violation of which civil liability was specifically created. The original Securities Act of 1933 provided a limitation of two years from discovery of the alleged misrepresentation for all civil actions under the Act, and a ten year over-all limitation for all actions except those under Section 12(2) (May 27, 1933, ch. 38, Title I, § 13, 48 Stat. 84). The 1934 amendments to the Act, however, reduced the limitation periods within the Act to one year from discovery or three years from the time of wrong, whichever is less. In view of this circumstance, Petitioner's contention that the two year period from date of discovery applied in this case is less consistent with federal policy than the three year period of Florida's fraud statute makes little sense.

The argument that the longest possible limitations period should be selected for Section 10b cases has been made and rejected in recent decisions. *Nickels* v. *Koehler Management Corporation,* 392 F.Supp. 804, 808 (N. D. Ohio 1975); and *Hitchcock* v. *de Bruyne,* 377 F.Supp. 1403, 1407 (D. Conn. 1974). The Court in *Nickels,* clearly summarized the rationale of these cases, stating:

> "This virtually unbroken pattern of limitations of one year from discovery and absolute bar after three

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* *Holmberg* v. *Armbrecht,* 327 U.S. 392 (1946), *Tomera* v. *Galt,* 511 F.2d 504 (7th Cir. 1975); and *Vanderboom* v. *Sexton,* 422 F.2d 1233 (8th Cir. 1970).

> years from sale or other event strongly suggests a Congressional policy favoring short limitations periods rather than the longer ones found in many states' common law fraud statutes. . . . Unduly long limitations periods would appear to permit those who claim to be aggrieved by violations of the Act to lie in wait for the stock market to take a propitious turn before they visit the courthouse. While this Court has little sympathy for those who prey on the gullible and the unwary, the fact that Congressional policy is to protect the innocent investor does not mean that Congress also intended to favor one who loses his innocence and then waits to see how his investment turns out before he decides to invoke [the Act]."

Even if it were consistent with federal policy to apply the longest possible statute of limitations, uniform application of the fraud statute would not accomplish this purpose. The one year fraud periods in Alabama and Louisiana which were applied in the *Weisser* and *Hooper* cases were obviously not the longest available, and in *Berry Petroleum Company* v. *Adams & Peck,* 518 F.2d 402 (2nd Cir. 1975), the Court chose the three year limitation period under the Texas Securities laws over the shorter two year fraud statute.

The view that fraud limitation periods should always be applied because both fraud and Section 10 actions require scienter is also simplistic and erroneous. The Court's decision in *Ernst & Ernst* v. *Hochfelder,* —U.S.—, 47 L. Ed. 2d 688 (1976), leaves the exact nature of the scienter requirement under Section 10b in doubt by indicating that reckless conduct may be sufficient (fn. 12), and, in any event, scienter is only one of several elements of a Section 10b action. Each of these elements are reflected in varying degrees in the securities and fraud laws of any particular state, and all must be considered. Moreover, there are states in which fraud actions do not require proof of scienter, states in which proof of scienter is required under

the state securities laws, and states in which both or either of the fraud and securities laws require some modified form of scienter. The modern trend of decisions in the fraud area, in fact, has been to dispense with the requirement of scienter and to recognize actions based on grossly or ordinarily negligent misrepresentations. This trend was noted in the recent Section 10b case of *Cash* v. *Frederick & Company, Inc.*, 57 F.R.D. 71, 76 (E.D. Wis. 1972), in which the Court stated:

> "It now appears that a fraud action itself no longer requires scienter, but is fast becoming satisfied with proof that, considering all the circumstances, the defendant did not act as would the ordinarily prudent person to avoid misrepresentations, either express or by omission. Note, 63 Mich.L.Rev. 1070, 1079 (1965); United States v. Schaefer, 299 F.2d 625, 629 (7th Cir. 1962); Sevenson v. Barwineck, 8 Wis. 2d 557, 99 N.W. 2d 690 (1959) (Fairchild, J.). Thus, it is possible that courts which have spoken in negligence language have not totally departed from a fraud theory but are only reflecting a basic liberalization in the concept of fraud itself."

Several decisions illustrate the inappropriateness of a blanket determination that the fraud limitation period must be applied in every forum state as a result of the scienter requirement. In *Klapmeier* v. *Peat, Marwick & Mitchell & C., supra,* 353 F.Supp. 1212 (D. Minn. 1973), the Court chose to apply the fraud limitations period for several reasons among which was the fact that a Minnesota fraud action *does not* require proof of scienter. In *Berry Petroleum Company* v. *Adams & Peck, supra,* 518 F.2d 402 (2nd Cir. 1975), the Court applied the Texas securities law limitation period although scienter was required in a Section 10b action in that Circuit, but was not required by the Texas securities laws. The Court recognized this difference, but found that other factors justified application of the securities limitation period regardless of it. And in *Hitchcock*

v. *de Bruyne,* 337 F.Supp. 1403 (D. Conn. 1974), the Court chose to apply the securities law limitation period, rather than the fraud period, because, among other things, the Connecticut securities laws *required proof of scienter.*

Adoption of petitioner's position that the forum state's fraud statute must always be applied in a Section 10b action would, in fact, destroy the only element of consistency which is important with respect to limitation periods. Such a holding would result in a change in the limitation periods applicable to Section 10b actions in the majority of jurisdictions where this issue has already been resolved. Although such a change might either shorten or lengthen the applicable period, it would, in every case, defeat the expectations of many actual or potential litigants who have acted, or refrained from acting, in reliance on prior decisions.

The very decisions of the Ninth Circuit upon which petitioner relies in its attempt to establish a conflict among the Circuits, expressly recognize the overriding importance of the need to maintain consistency in the application of limitation periods. In *Douglas* v. *Glenn E. Hinton Investments, Inc.,* 440 F.2d 912 (9th Cir. 1971), for example, the Court chose to apply Washington's fraud statute rather than its securities law statute. In reaching this decision, the Court cited several prior cases which had applied the Washington fraud statute to Section 10b actions prior to enactment of Washington's securities law. It then concluded that, regardless of factors which indicated that the state Securities Act limitation period would be applied if the question had not been previously considered, the need to maintain stability as to the applicable statute was of overriding significance. It stated (440 F.2d at 916):

> "Moreover, for us to change the applicable limitation period because the local law of securities regulation has changed would add an unnecessary uncertainty to the prosecution of federal claims under section 10(b). We

> do not believe federal policy is advanced by changing the law governing the timeliness of federal claims to correspond with each change in the substantive elements of a claim under the local securities law. Aggrieved persons have come to rely upon our prior holdings. Reasonable stability in laws pertaining to voluntary relationships between parties, and the right of access to the courts to question those relationships, is a worthwhile objective as well."

Accord: *United California Bank* v. *Salik,* 481 F.2d 1012 (4th Cir. 1973).

In short, the issue of which of the limitation periods of the forum state to apply in a Section 10b action is one which is not capable of a single national resolution. The variations among the laws of the several states requires a careful individual analysis of those laws before an appropriate determination can be made. Such an analysis will inevitably result in the application of different types of limitation periods in different states, but such differences are necessary if the most appropriate period is to be applied in each case.

II. THE CHOICE OF LAW ISSUES IN THIS CASE RAISE NO SIGNIFICANT FEDERAL QUESTION.

Petitioner's contention that this Court should determine whether Florida or Rhode Island law applies to the facts of this case is without merit. The resolution of the choice of law issues raised are dependant on a review of the conflict of law principles of the forum state of Florida and an application of those principles to the unique facts of this case. Obviously, the interpretation of principles applied by Florida courts or the application of those principles to the facts present here raise no federal question, much less a question of sufficient significance to justify this Court's attention.

III. THE PROPRIETY OF THE DISTRICT COURT'S ENTRY OF SUMMARY JUDGMENT RAISES NO SIGNIFICANT FEDERAL QUESTION.

The question of the propriety of the District Court's entry of summary judgment has been fully reviewed and affirmed by the Court of Appeals. Petitioner does not contend here that the trial court applied any erroneous principle of law in entering the judgment, nor does it point to anything in the record establishing the existence of a disputed issue of material fact. Instead, it relies on vague generalities with respect to the extent of the discovery which was had and the existence of potential expert witnesses who might have testified on Grant's behalf. The scope of discovery, coupled with petitioner's failure to identify any material factual issue, merely confirms the propriety of the District Court's judgment, and, certainly, the addition of expert testimony on behalf of Grant would add nothing to petitioner's case. Petitioner had the opportunity to rely on all the discovery material filed in the case, and to file its own affidavits, in opposing Grant's motion for summary judgment. Despite this opportunity, no material factual issue has ever been raised.

CONCLUSION

For the foregoing reasons, Alexander Grant & Company respectfully requests that the Petition for Certiorari be denied.

Respectfully submitted,

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